OREGON CENTER for PUBLIC POLICY

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Issue Brief

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No Contest

Why expanding the Earned Income Tax Credit is better for working families and Oregon than the Tax Bracket Increase

Next year, the Oregon Legislative Assembly may face two different income tax measures purporting to help working families.

One plan, proposed by Republicans in the legislature, would double the size of Oregon's two lowest income tax brackets, doubling the share of income that is taxed at 5 and 7 percent (hereinafter, the "Tax Bracket Increase").[1] Its supporters claim that under their plan "help goes to those that need it most."[2]

The other plan, proposed by Oregonians for Working Families, would expand Oregon's Earned Income Tax Credit (EITC) to 18 percent of the federal EITC.[3] Oregon's EITC, currently 6 percent of the federal credit, was created in 1997 with strong bipartisan support that recognized the credit's effectiveness and efficiency in helping working families. Many states have state EITCs, and Oregon's credit currently stands as one of the nation's smallest.

Which proposal is better? In a head-to-head matchup, it's no contest: the EITC expansion is better for working families and for Oregon. The EITC expansion better targets help to low- and moderate-income working families — those most in need— and does so for a fraction of the cost of the Tax Bracket Increase.

Only the EITC targets help to working families most in need

Under the Tax Bracket Increase, the bulk of the benefits do *not* go to those most in need. The Tax Bracket Increase gives less than one-third (29 percent) of the reduced tax revenue to households with incomes below $40,000.[4] Not only does a small share of the benefits get to low-income families, but the Tax Bracket Increase also provides a tax break for millionaires, because all Oregon income taxpayers pay taxes based on the portion of their income in the lowest tax brackets that the plan would expand. Last the Tax Bracket Increase benefits non-working households. The measure does nothing to limit its tax cut to working families.

By contrast, under an expanded EITC 100 percent of the tax break would go to working households making under $40,000. Millionaires would receive no tax break. And families must have income from work to qualify.

In other words, while the Tax Bracket Increase gives a tax break to millionaires and offers less than one-third of its benefits to households with incomes below $40,000, the entirety of the EITC expansion hits the target: low- and moderate-income working Oregon families who need help the most.

The Tax Bracket Increase would cost seven times more than an EITC expansion

The Legislative Revenue Office (LRO) has calculated that the Tax Bracket Increase would cost $375 million in one year.[5] Since Oregon budgets for two years, the costs should be put in biennial terms. That is, based on LRO estimates, the plan likely would cost about $750 million in 2009-11, or about 5 percent of projected General Fund revenues.

By contrast, increasing the EITC to 18 percent of its federal counterpart would cost only about $100 million in 2009-11, or about 13 cents for every dollar spent under the Tax Bracket Increase.[6]

The Tax Bracket Increase would harm public structures; the EITC expansion would not

Proponents of the Tax Bracket Increase have proposed that the plan be paid for primarily through a 5 percent across-the-board reduction in the state budget.[7] Given that about 90 percent of the state budget goes to public safety, education and human services, the budget cuts needed to pay for the Tax Bracket Increase would hurt all Oregonians.

The more affordable EITC expansion, by contrast, does not require substantial across-the-board budget cuts. No one has proposed such cuts to fund an EITC expansion. Finding revenue for increasing the EITC is a matter of priorities. For instance, few would argue that it should be a priority to tax the income of poor Oregonians more than the income of the rich, yet that is what Oregon's current tax system does.[8] Expanding the EITC itself would improve the fairness of the state tax system, and the expansion can be paid for by further actions designed to make Oregon's tax system progressive.

The Tax Bracket Increase does not provide immediate economic stimulus

While proponents of the Tax Bracket Increase assert that it would provide "economic stimulus," the claim does not stand up to scrutiny.[9] The proponents are misusing a staff analysis of the measure and wrongly assume that state government spending does nothing for the economy.

The jobs that the Tax Bracket Increase proponents claim will be created are hypothetical

The proponents' "economic stimulus" claims stem from a Legislative Revenue Office estimate that uses the Oregon Tax Incidence Model (OTIM). OTIM makes a prediction about how the Oregon economy might respond to a tax cut over a hypothetical five-year time period. OTIM does not adequately account for the economic impact of the spending cuts sought by proponents of the Tax Bracket Increase to pay for the tax cut.[10] No one knows whether the jobs predicted by the model would actually materialize, and there is no way to track whether they materialize. Similarly, no one is or can be held accountable for whether any jobs projected by OTIM actually materialize.

The proponents' claim that the Tax Bracket Increase would create a significant number of new jobs to address today's economic shortfall is wrong

The proponents point to OTIM's estimate that the proposal will create 19,951 jobs to imply that their measure will help Oregon during the current economic downturn. Yet the current economic downturn likely will be over by the time the hypothetical 19,951 jobs would materialize, if they ever do.[11] The OTIM projection of new jobs looks over a five-year time period. When analyzing the model's results, LRO assumes the new jobs are distributed evenly over five years, or 3,990 jobs per year. Thus, at the end of the first year, if the jobs actually materialize, they would total just one-fifth the level claimed by the Tax Bracket Increase proponents. The soonest the law could go into effect would be for tax year 2009, making the first-year impacts on jobs, if any, reach into 2010. The proponents' claim that their plan will stimulate the economy to address today's economic problems misses the mark. Any impact would be too little, too late.

The Tax Bracket Increase proponents' proposal for an across-the-board spending cut to pay for the measure was not a factor in the economic analysis

An across-the-board spending cut as proposed by the Tax Bracket Increase proponents would affect the amount of federal revenues that flow into Oregon's economy. Federal assistance is designed to match state spending in some program areas, most notably Medicaid. Because the Tax Bracket Increase calls for across-the-board service cuts, it threatens to reduce the amount of federal matching funds entering Oregon's economy.

The dollars and economic impacts of the missing federal funds are significant. Three-quarters of federal funds that flow into Oregon's economy through the state budget are in the human services area. This budget period, the Department of Human Services will disperse in Oregon about $7,000,000,000 ($7 billion) in federal funds, mostly Medicaid dollars.[12] A 5 percent across-the-board reduction could take upwards of $300 million out of Oregon's economy in the human services area alone.

Usually tax cut proposals do not include a method of paying for the lost revenue, so OTIM analyses merely consider the revenues lost to state government, not any other funds associated with those lost revenues under specific budget cut proposals. Here, however, the proponents have included an across-the-board spending cut with the proposal, which will result in less federal matching funds flowing to Oregon. LRO did not incorporate the impact of this loss of federal funds on Oregon's economy into the OTIM analysis of the Tax Bracket Increase. As a result, the analysis did not consider any job losses in the state's health care system due to the loss of federal Medicaid dollars or the economic effects of a likely increase in the share of Oregonians without health insurance.

The Tax Bracket Increase proponents wrongly assume state spending has no economic impact

Proponents of the Tax Bracket Increase seem to think state government spending has no impact on the economy. The proponents' claims that the plan will "pump millions of dollars into our stagnating economy" or that it "puts $375 million back into the economy every year" wrongly assume that the money isn't already in the economy when state government spends it.[13] These assertions ignore the fact that state government otherwise would be pumping that money into the economy and, as noted above, often attracting and putting into the economy additional federal matching dollars.

State government is a major economic force in Oregon. Beyond its obvious impact on the public labor force and on the state's public infrastructure, significant state funds flow to private Oregon businesses, from hospitals, doctors and child care facilities to printers, computer programmers and vendors of office equipment and supplies. Oregon spends much of its money, and matching dollars from the federal government, in Oregon with Oregon businesses. The implied assertion that the state wouldn't put the $375 million in taxes into the economy makes no sense.

The Tax Bracket Increase adds some fairness with one hand but takes it away with the other, while the EITC just adds fairness

Oregon's overall state and local tax system is regressive, requiring the poorest families to pay a higher share of their income in taxes than is required of the richest Oregonians.[14] Improving the fairness of the state's tax system would help promote opportunity for Oregon's most vulnerable working families and help build an economy of shared prosperity.

Proponents of the Tax Bracket Increase correctly note that Oregon's highest income tax bracket kicks in at a relatively low level of income and that adjusting the three brackets upward would make the state tax system fairer for many low-income Oregonians. Compared to the EITC expansion, which raises the income level that low-income working families start paying taxes on, thus increasing the income level at which they reach the highest tax bracket, it's hard to say that the Tax Bracket Increase advances the overall fairness of the system. It hands tax breaks to households who don't need them and triggers across-the-board service cuts that would harm all Oregonians, including low- and middle-income working families.

One way to address these two main flaws of the Tax Bracket Increase is to add a fourth, higher income bracket. By adjusting the brackets upward while also establishing a fourth, higher-rate bracket at upper-income levels, the improvement could pay for itself.

There are other options for restructuring Oregon's income tax rates that could improve the system's fairness without generating massive service cuts. For instance, some states require higher-income taxpayers to pay the top rate on all their income.[15]

That said, if the goal is to improve the fairness of the state's income tax system for working families, increasing the state EITC is an efficient mechanism since it targets the tax break to low-income working families with children. While additional steps would be needed to make Oregon's overall state and local tax system progressive, expanding the state EITC is the most appropriate first step.

Conclusion

Which proposal is better for working families and Oregon, the Tax Bracket Increase or increasing the Earned Income Tax Credit? When it comes to enacting a tax plan to help working families in Oregon, it is no contest. An expansion of the EITC is superior to the Tax Bracket Increase. It is targeted to low- and moderate-income working families, is less costly, would not harm public structures and adds fairness to Oregon's tax system.

Endnotes:

[1] Ted Ferrioli, "Legislature Should Give Tax Relief to Working Families," *Salem Statesman Journal,* January 26, 2008, available at http://tinyurl.com/63w74q; Senator Ted Ferrioli, "Senator Ferrioli Proposes Tax Relief for Working Families," news release, February 8, 2008 available at www.leg.state.or.us/press_releases/ferrioli_020808.pdf; [Ferrioli], "Working Family Tax Cut, Job Creation, and Accountability Package," (not dated), available at www.leg.state.or.us/ferrioli/taxcut_package_021908.pdf; Senator Ted Ferrioli, "Local Job Creation Needed in Light of Rising Unemployment," news release, June 19, 2008, available at www.leg.state.or.us/press_releases/ferrioli_061908.pdf; Oregon House Republicans, "House Republicans Support Plan to Provide Tax Fairness, Help Working Families with Rising Costs," news release, July 22, 2008, available at www.leg.state.or.us/press_releases/hro_072208.pdf. The Tax Bracket Increase proposal is not part of the Senate Republicans' 2009 legislative agenda; see Senate Republican Office, "Senate Republicans Announce 'Real Solutions. Right Now.' Agenda," news release, July 31, 2007, available at www.leg.state.or.us/press_releases/sro_073108II.pdf; and Oregon Senate Republicans, "Real Solutions.

Right Now.: 2009 Legislative Priorities of the Oregon Senate Republicans," available at www.leg.state.or.us/press_releases/sro_073108.pdf.

[2] Oregon Senate Republicans, "Capitol Update," email newsletter, June 5, 2008.

[3] Oregonians for Working Families, www.oregoniansforworkingfamilies.org, is a coalition formed to promote the proposal to expand Oregon's EITC. OCPP and the Oregon Hunger Relief Task Force co-chair the coalition.

[4] OCPP analysis of data from Legislative Revenue Office.

[5] Chris Allanach, Legislative Revenue Office, memorandum to Senator Ferrioli, "The Impact of Doubling the Personal Income Tax Brackets," January 23, 2008. Notably, proponents of the Tax Bracket Increase have stated that the program is "estimated to cost $360 million" but will put $375 million "back into the economy." Compare, e.g., Ferrioli, "Senator Ferrioli Proposes Tax Relief"; Ferrioli, "Local Job Creation Needed"; and Oregon House Republicans, "House Republicans Support Plan." The claim that the cost is $360 million is based on LRO's analysis that, five years after implementation, the revenue impact would be $360.8 million per year (in 2008 dollars), once certain economic feedbacks from the tax cut are taken into account. The $375 million figure is the "static," or initial, actual cut to revenues the first year the tax cut would be implemented and is the annual cost that would be used in setting the state budget should the legislature adopt the proposal. In other words, the claim that the Tax Bracket Increase is "estimated to cost $360 million" understates the actual annual cost to state government by $15 million and is less than half the actual biennial cost.

[6] The Legislative Revenue Office estimates that increasing the Oregon EITC from 6 percent to 18 percent of the federal EITC would cost $99.7 million in 2009-11 and $97 million in 2011-13. E-mail message from Chris Allanach, Legislative Revenue Office, to Mike Leachman, OCPP, April 18, 2008.

[7] See Ferrioli, "Senator Ferrioli Proposes Tax Relief"; and [Ferrioli], "Working Family Tax Cut, Job Creation and Accountability Package." The proposal was never actually introduced as legislation in the 2008 special supplemental session.

[8] The richest 1 percent of non-elderly families in Oregon pay just 7.8 percent of their income in state and local taxes, while the poorest fifth of families pay 9.2 percent. This regressivity looks even worse when you account for the fact that Oregon taxpayers can export to the federal government a portion of the state income taxes and local property taxes they pay, since those taxes are deductible on federal income tax returns if you itemize. That tax break helps wealthier families more, so after including that federal offset, the share of income paid by the richest 1 percent of families falls to just 6.7 percent, again compared to 9.2 percent of income for the lowest-income families. See Institute on Taxation and Economic Policy, "Oregon: State and Local Taxes in 2008, Shares of Family Income for Non-elderly Taxpayers," available at www.ocpp.org/resources/2008WhoPays20080424.pdf.

[9] See, e.g., Ferrioli, "Local Job Creation Needed."

[10] As noted in the text below, OTIM ignores the economic impact of the reduced federal matching funds that would result from the Tax Bracket Increase proponents' proposal to pay for the tax cut with an across-the-board cut to the state budget.

[11] For instance, the June 2008 Oregon Economic and Revenue Forecast, available at www.oregon.gov/DAS/OEA/docs/economic/forecast0608.pdf, projected that jobs would start growing again in the fourth quarter of 2008.

[12] Legislative Fiscal Office (LFO), *Budget Highlights: 2007-09 Legislatively Adopted Budget*, September 2007, available at www.leg.state.or.us/comm/lfo/2007-09_budget/2007-09%20Budget%20Highlights.pdf.

[13] See, e.g., Ferrioli, "Legislature Should Give Tax Relief"; Oregon House Republicans, "House Republicans Support Plan"; and Ferrioli, "Local Job Creation Needed."

[14] See endnote 8.

[15] New York and Nebraska have provisions that create this effect.

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